1. **Cooperation with the AG**

One of the more significant allegations in the AG's letter to the Public Accounts Committee is that *"the Board and Senior Management of the IESO did not fully cooperate with us during the conduct of our work,"* and that consequently the AG was unable to provide an audit opinion. The passage continues:

> *In order for us perform our work in accordance with Canadian Auditing Standards we require certain information on all of our audits. Unfortunately, the Board and Management of the IESO consistently refused (while all the time insisting in correspondence that they were cooperating) to provide us with written acknowledgement of their roles and responsibilities with respect to our audit, nor would management sign a representation letter confirming that they have provided us with all relevant information that may affect the financial statements. No valid reason for these refusals was provided to us.*

Questions:

- How does IESO characterize its cooperation with the Auditor General? (Terry)

The IESO has fully cooperated with the Office of the Auditor General of Ontario with respect to their special audit of the IESO. The IESO recognizes the Auditor General's statutory role and authority to perform an audit of the IESO and has cooperated fully throughout the special audit process.

Over an eleven week period, IESO staff met with OAGO staff on over 40 occasions and responded to over 200 information requests. The IESO also arranged for working accommodations for seven OAGO staff on IESO premises over that 11-week period, complete with access to a private meeting room for their sole use, as well as direct access to IESO employees. Further, the IESO designated a staff member to assist in coordinating meeting and information requests to ensure they were done in a timely manner.

This spirit of cooperation is one that the IESO has followed in all of its previous engagements with the OAGO. In addition to the meetings held with IESO staff, the IESO also complied with numerous requests from Ms. Lysyk to attend meetings of the IESO's Audit Committee and the full IESO Board of Directors.

- Did management and the board fail to provide the above documentation, as described? If so, why not? Alternately, what's the truth of the matter?(Terry)

The management representation letter and signed audit planning report for 2017 fiscal year financial statement audit had been signed with KPMG. In line with the Board's obligation under s. 25.2. of the *Electricity Act*, 1998, the Board engaged KPMG, an independent third-party auditor, to conduct the IESO's 2017 financial statement audit. As the Auditor General's Office was not formally engaged to perform this audit, the IESO was not in a position to sign the aforementioned documents.

While the AG was not engaged as the IESO's auditor given the existing relationship with KPMG, any information that was shared with KPMG along with all other information relevant to the 2017 financial statements, was also shared with the OAGO. In recognition of the Auditor General's work, a copy of the management representation letter between the IESO and KPMG was provided to her office.

Moving forward, the IESO is considering the Auditor General's request to have her serve as the IESO's auditor for the fiscal 2018 financial statements.

2. **Collateral and Security Disclosure on Financial Statements**

Note: There are two sets of questions that have been received by the reporter at the Globe, with very similar premises, both are found below.

Another issue is this whole business regarding the IESO pledging future collection of revenues. The AG has said that "*the assets of IESO have been pledged as collateral and security against the Fair Hydro Trust...what it means is that the generators fall behind the creditors for the Fair Hydro Plan Trust. We asked management and the board to disclose this in their financial statements and they have not.*"

Questions:

- Whom at IESO did the AG ask to make this disclosure, and when?

On March 20, 2018 the IESO received a draft audit report from the Auditor General's Office. Included in the draft report was a recommendation for the IESO to disclose the Security Agreement and the pledging of market receivables as collateral in the financial statement notes.

- What was IESO's response?

The IESO is reviewing this recommendation and will be developing a response for inclusion in the final audit report. The IESO expects to share the response with the Auditor General's office this week.

- Is the AG's characterization—that generators fall behind the creditors for the Fair Hydro Plan Trust—correct? Why or why not?

It is important to note that the security is only collateral for the current month carrying costs owing to Fair Hydro Trust, and not creditors for the Trust. Additionally, not all IESO assets have been pledged. Only receivables due in a month from local distribution companies and electricity retailers (defined as "Electricity Vendors" in the Fair Hydro Act) have been pledged. Carrying costs owing to Fair Hydro Trust will end in July 2021.

This means that the security will only be called if the IESO fails to pay carrying costs to the Fair Hydro Trust in a month, which is highly unlikely, as the payment obligation for carrying costs is small relative to the entire amount settled each month. Further, both Moody and DBRS have not changed the IESO's public credit rating despite the IESO providing this security.

- If IESO chose not to disclose this in its financial statements, why not?

As noted above, this recommendation is still under consideration by the IESO.

- The AG said that it knows that IESO "thought it was a risk, that the generators would not like this." Is that in fact the case?

[redacted]

According to the Auditor General, IESO's assets have been pledged as collateral and security against the Fair Hydro Trust. She told the Public Accounts Committee:

What it means is that the generators fall behind the creditors for the Fair Hydro Plan Trust. We asked management and the board to disclose this in their financial statements, and they have not. I think we're still wondering why they won't, other than the fact that we know that they thought it was a risk, that the generators would not like this. Bruce Power would be concerned that IESO pledged as collateral the incoming revenues they would receive from the LDCs.

Questions:

- Did the AG in fact ask IESO's board and management to disclose this fact in the IESO's financial statements?

On March 20, 2018 the IESO received a draft audit report from the Auditor General's Office. Included in the draft report was a recommendation for the IESO to disclose the Security Agreement and the pledging of market receivables as collateral in the financial statement notes.

- If so, what determination did the board and management make, and why?

A determination has not yet been made. The IESO is in the process of developing a response for inclusion in the final audit report.

- Has the IESO informed generators about this? If so, when? If not, why not?

After careful consideration, it was determined that granting the security would be unlikely to have a negative impact on generators. The payment obligation that is supported by this security is a small proportion of the total amount settled in a month. The IESO considers it highly unlikely the security will ever be called. Further, the IESO is considering including this information in its financial statements, which will be released publicly on or before March 31, 2018.

3. **KPMG and IESO involvement in FHP** *(request for response from Chair of Audit Committee)*

The Auditor General has made a number of statements about the relationship between the AG, the IESO, KPMG and the government. Questions naturally arise from these statements, and I wanted to put them to the chair of IESO's audit committee.

Questions:

- The AG has said that it has confirmed that IESO's adoption of rate regulated accounting "were directly related to the Fair Hydro Plan." Is this true? Why or why not?

The IESO adopted its new accounting policies on March 15, 2017. The decision to adopt regulatory accounting was made to allow for financial reporting that was more relevant to the needs of our financial statement users and enabled greater transparency into the market transactions we oversee, which amounted to over $17 billion last year.

As a crown controlled corporation, we work closely with government on a regular basis. In contemplating the accounting policy change in March 2017 for our 2016 financial statements, we consulted with government and our independent external auditors at KPMG to ensure that any change would be applicable with current and future government policy. KPMG issued an unqualified opinion on the IESO's financial statements, and the change in accounting practices.

- The AG's office has said that the IESO treated its "audit team like we were subservient to KPMG. In terms of the law in Ontario, that would be the reverse." The AG has described KPMG as a "component auditor" and itself as a "parent auditor," and that KPMG therefore has obligations to the Auditor General's office. What is the audit committee's understanding of KPMG's obligations to the Auditor General?

The IESO understands the following obligations as outlined in the Auditor General's Act:

(3) Where the accounts of a Crown controlled corporation are audited other than by the Auditor General, the person or persons performing the audit,

(a) shall deliver to the Auditor General forthwith after completion of the audit a copy of their report of their findings and their recommendations to the management and a copy of the audited financial statements of the corporation;

(b) shall make available forthwith to the Auditor General, when so requested by the Auditor General, all working papers, reports, schedules and other documents in respect of the audit or in respect of any other audit of the corporation specified in the request;

(c) shall provide forthwith to the Auditor General, when so requested by the Auditor General, a full explanation of work performed, tests and examinations made and the results obtained, and any other information within the knowledge of such person or persons in respect of the corporation. R.S.O. 1990, c. A.35, s. 9 (3); 2004, c. 17, s. 11.

- Is the audit committee satisfied that KPMG has communicated in a fair, open and transparent manner with the Auditor General's office? Why or why not?

It is our understanding that KPMG has responded to all requests from the Auditor General and her Office. We also understand that KPMG met with the OAGO on a number of occasions to discuss the relevant account issues, and to share relevant correspondence and documentation.

The IESO had asked KPMG to deliver their audit report to the Auditor General's Office and make available their working papers in respect of the audit, in line with their obligation under the Auditor General's Act.

- The AG has raised concerns about the fact that KPMG provided advisory services concerning the Fair Hydro Plan while also auditing IESO's financial statements. Why was this arrangement acceptable to the audit committee?

KPMG was among those consulted by IESO on accounting matters relating to the Fair Hydro Plan. It is very common for auditors to provide advisory services to help their clients understand the application of complex accounting matters.

4. **<u>Date of Financial Statement Publication</u>**

- What date will the IESO's 2017 financial statements be published?

The IESO is required to submit an annual report to Minister of Energy within 90-days of fiscal year-end. As such, the IESO expects that its annual report, which includes the 2017 financial statements, will be published before the end of March.

5. **<u>Questions received earlier today:</u>**

a) The Auditor General has said that her office requested something called bank reconciliations from the IESO, and that the IESO "couldn't provide any to us." Apparently the AG regards this as a big deal. My questions:

- What are bank reconciliations?

Bank reconciliation is a process that is used to match the balance of a company's general ledger account to its bank statement balance.

With respect to the IESO's bank reconciliation process, the IESO uses a third-party treasury service provider to conduct independent daily bank transaction polling and reporting. This system is quite sophisticated in that it is automatic. Once bank transactions are properly vetted and checked by IESO staff, the third-party system will prepare journal entries and will export those entries to the IESO's general ledger. In other words, the general ledger is populated with all bank transactions.

The IESO settles more than $17 billion dollars every year, or over $1.4 billion every month. It is common for large organizations with a high-volume of bank transactions to use an automated third-party treasury system to support their bank reconciliation process, similar to what the IESO uses.

- When did the AG's office request to see these bank reconciliations?

On December 14, 2017 the IESO received an initial request listing from the Office of the Auditor General of Ontario (OAGO). Included in this request listing was a request for "Bank reconciliations for each bank account as at December 31, 2017".

- What was IESO's response?

Over the course of the audit period, the IESO provided the OAGO with bank reconciliations for each of its accounts. Each reconciliation was provided in the form of an excel spreadsheet that showed the balance of the bank account and corresponding general ledger account, as at December 31, 2017.

- If the IESO did not provide them to the AG, why not?

Not applicable – see response above.

- Did KPMG every raise this issue with IESO? If so, when and how?

The issue of the IESO not preparing bank reconciliations has not been raised by any of the IESO's previous auditors, including KPMG.

The IESO engages in an annual independent third party audit of its financial statements, which includes an audit examination of bank transactions and IESO's internal controls. The IESO also conducts a bi-annual audit of its internal controls over the market settlement processes, which includes a review of controls over bank transactions. Most recently, these services have been performed by E&Y. Again, this has not ever been raised as an issue.

b) How much has IESO paid KPMG each year since its inception? If possible, please break out the value of the auditing work from any consulting work.

The IESO and OPA merged on January 1, 2015. The fees paid to KPMG for services performed since the merger are outlined below.

[redacted]

	2015	2016	2017
1 Annual Financial Statement audit	86,000.00	91,969.50	86,500.00
2 Accounting advisory services			652,907.00
3 Tax advisory services	31,518.00	37,950.00	18,965.00
4 Other advisory services:			
Merger integration assistance	292,871.20		
Procurement advisory project	67,655.50		
Cultural alignment project		31,500.00	
IT Corporate Governance			14,685.00
	478,044.70	161,419.50	773,057.00